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C O N F I D E N T I A L SECTION 01 OF 02 AMMAN 005240

SIPDIS

TREASURY FOR OASIA -- MCDONALD
CENTCOM FOR POLAD

E.O. 12958: DECL: 09/12/2007
TAGS: EFIN PREL ETRD JO IZ
SUBJECT: JORDANIAN ASSESSMENT OF ECONOMIC IMPACT OF POSSIBLE IRAQ HOSTILITIES

REF: AMMAN 4697

Classified By: CDA GREGORY L. BERRY. REASONS 1.5 (B) AND (D)

¶1. (c) Post has faxed to NEA/ARN a copy of a paper given to DAS Satterfield by Prime Minister Abul Ragheb that describes a preliminary Jordanian government interagency assessment of the economic impact on Jordan of possible military hostilities involving Iraq. The paper assumes and attempts to quantify the value of the loss of grant and subsidized oil shipments for Iraq, as well as knock-off effects on government revenues and the transportation, tourism, and export industries. It estimates the total cost to the Jordanian economy at about $1.4 billion. Copies of the paper are available from NEA/ARN.

¶2. (c) Foreign Minister Muasher told the Charge that he would like to discuss the paper during meetings he has requested in Washington with the Secretary and other senior U.S. Government officials. Central Bank governor Umayya Touqan has also raised a related issue related to impact on Jordan's banking system of an abrupt halt in UN Oil for Food Program trade with Iraq (reftel). We would also appreciate Washington guidance on the issue Touqan raised.

¶3. (c) In post's view, given an overall absence of detail, the numbers provided in the Jordanian paper are hard to assess. Yet, it seems clear that loss of the oil subsidy would be a major economic hit to Jordan. Although the adjustment to market-based oil prices is probably a good thing in the long-term, the transitional economic costs will no doubt be significant and painful, particularly at a time when the Jordanians would be facing major social dislocations because of a conflict. On the other hand, Jordan has resources of its own to deal, at least in part, with the other identified costs, which are mostly temporary. Following are some additional points that may prove useful in Washington's analysis of the paper and the issues it raises.

-- The paper mentions in passing the possible need to provide for refugee flows, but does not quantify the potential need. The Jordanian government has been reluctant for political reasons to discuss with the embassy or humanitarian organizations its planning for this eventuality. The Department may want to suggest to FM Muasher that low-key contingency planning by the Jordanians with the international community wuold be prudent.

-- The calculation of the value of the Iraqi oil grant and subsidy is probably actually underestimated to the extent that it sets a higher than market value on the low-quality consumer goods exported to Iraq under the oil for goods protocol. Viable alternative markets probably do not exist for most (60-70%?) of such goods, so the loss of the Iraqi market would mean a permanent loss of income and jobs for a significant portion of Jordan's manufacturing sector.

-- The paper lumps together permanent and temporary shocks. Permanent shocks would include the higher national oil bill at market prices and the probable loss of Iraq as a captive market for low-quality consumer exports. Temporary shocks include the impact on port and land transport, loss of tourism and remittance income.

-- Depending on the scenario, the temporary shocks could be quickly reversed and even turn into "positive shocks." (Note that real GDP grew by over 20% in 1992.) Similarly, the opportunity for Jordan of the reopening of the Iraqi economy to normal business is not addressed.

-- In addition to not addressing offsetting factors, the paper does not discuss resources currently available to Jordan. These include $5 billion in official reserves, $1.5 billion in claims on Iraq, and substantial foreign assets of the banking system and private sector, as well as the increased credibility of the central bank and government.

-- Furthermore, it does not seem to consider savings on debt payments under the new Paris Club arrangement or the substantial increase in non-Iraq exports expected this year. Regarding the latter, it will be critical to keep QIZ exports flowing, especially via Haifa; otherwise there could be a

permanent damage to the initiative.

-- Another critical factor will be how the international banking community reacts during a crisis. Banks, especially but not only European and Japanese ones, could preemptively interrupt relationships with Jordanian banks ("redlining"), making it impossible for Jordanian banks to access overseas funds or clear international payments. This could lead to trade disruptions and defaults by Jordanian banks with messy and potentially long-lasting legal and financial consequences.

-- In addition to directly providing cash to the Jordanian government, there could be other ways to address some of the needs identified. For example, to minimize monetary instability and reduce the probability of a speculative hard currency outflow, the U.S. could announce a commitment to make additional temporary reserves available to the Jordanian Central Bank. This would also increase the ability of the Jordanian government to guarantee domestic lending or finance debt deferrals for hotels or other firms.

-- We could also consider U.S. government guarantees for borrowing by the Jordanian government or banks, although the U.S. budget cost of this would be equivalent to direct lending. For this reason, it is likely preferable to provide guarantees and lending through international institutions.

-- The IMF and World Bank would be probable sources of emergency funding and guarantees, as could be the international donor community. The Paris Club could also provide additional extraordinary debt relief, but this would be unlikely to provide much help in a crisis since the vast majority of debt payments due over the next six years were already deferred by the July Paris Club agreement.
BERRY